

Severance: Practical Guidance for the Departing Executive

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With rare exceptions, employment relationships are not permanent. Indeed, in many cases, executives and professionals should not expect guaranteed employment for a specific period of time, and should anticipate that their employment may end sooner than expected. Accordingly, severance has become an increasingly important component of an executive or professional's overall compensation.

Severance may include, among other things, base salary, earned but un-paid bonuses, pro-rata bonuses for a partial year of service, acceleration of deferred compensation and equity vesting, extended option exercise, health and executive benefits, and executive-level transition services.

The terms of severance are negotiable. However, in exchange, the executive or professional is often asked to affirm or agree to post-employment work restrictions, confidentiality, non-disclosure and non-disparagement covenants, and, almost always requires a release of legal claims.

If severance was not negotiated prior to or during the employment, it will have to be negotiated by the departing executive or professional. While every departure is unique, the concerns of the parties are relatively consistent. When preparing for such negotiations, consideration should be given to: (1) the precedent and practice; (2) post-employment obligations and restrictions; (3) public perception; and (4) possible claims.

I. Precedent and Practice

When negotiating executive and professional severance, precedent and practice matter. Lawyers talk about three types of law: the law of the land, the law of the industry, and the law of the shop. Although they may be enforceable under various theories of law, the latter two are not laws in the conventional sense. Rather, they tend to be followed simply because they embody the accepted principles by which an organization or industry operates. Such information may be obtained from a number of sources, including from regulatory filings, industry-specific compensation studies, or simply by word of mouth.

II. Post-Employment Obligations and Restrictions

If an organization has an on-going need for an executive or professionals services, or even if the organization simply wants the executive or professional to be available as needed during the transition, the executive or professional may be able to negotiate post-employment consulting compensation. Likewise, if the organization wants to restrict the executive or professionals professional activities after the departure, provided such restrictions are legally enforceable, additional compensation may take the form of “garden leave” and/or enhanced severance. Even if such restrictions had been obtained prior to or during the employment, such restrictions may be of questionable legal enforcement and an employer may seek to bolster enforceability through severance terms.

III. Public Perception

How an organization treats its departing employees impacts its ability to attract new talent. It also projects a message to the public about integrity and stability. Thus, many organizations value the ability to convey a message of a deliberate and thoughtful transition. In exchange, such organizations may be willing to provide a transition runway (such more time on payroll in a different position), protection of earned but unpaid compensation (such as forward vesting of equity and deferred compensation), and additional post-employment protections (such as enhanced or accelerated retirement benefits). Transition service providers may be retained to ensure a smooth transition, and communications professionals may be engaged to be sure that the message of that smooth transition is “the word on the street.”

IV. Possible Claims

Standing alone, bad, unkind, and even unfair employment actions are usually not unlawful. Rather, to be unlawful, the action must be illegal either in motive or in the means by which it is implemented – such as a succession planning decision motivated by unlawful age bias or a termination implemented in violation of the safeguards provided in an employment agreement. As a general rule, possible claims fall into the following four categories:

- Statutory Claims include certain whistleblowing and retaliation claims, discrimination claims, ERISA claims (such as interference with retirement or employee welfare benefits), and claims regarding the non-payment of “wages” (as such term is defined under applicable state and federal statutes).
- Contract Claims include not just breaches of explicit contract terms but also breaches of the implied covenant of good faith and fair dealing.
- Claims for Equitable Relief includes breach of the fiduciary duty claims that may arise from the nature of certain relationships such as partnerships and minority shareholder status.
- Tort Claims include defamation, tortious interference with advantageous or contractual relations, and intentional infliction of emotional distress.

V. Conclusion

Needless to say, not all departing executives and professionals have the necessary leverage to obtain or materially improve the terms of severance. However, in almost all circumstances, short of a

termination for cause or an organizations' dire financial circumstance, the payment of (or at least the request for) severance is anticipated. As a practical matter, the departing executive or professional should treat the negotiating of severance as they would the negotiation of any other term of employment – and leverage the circumstances discussed above to obtain the most favorable terms possible.

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